Economic Letter - July

The Fiscal Challenges of Barbados and Jamaica Have Different Causes

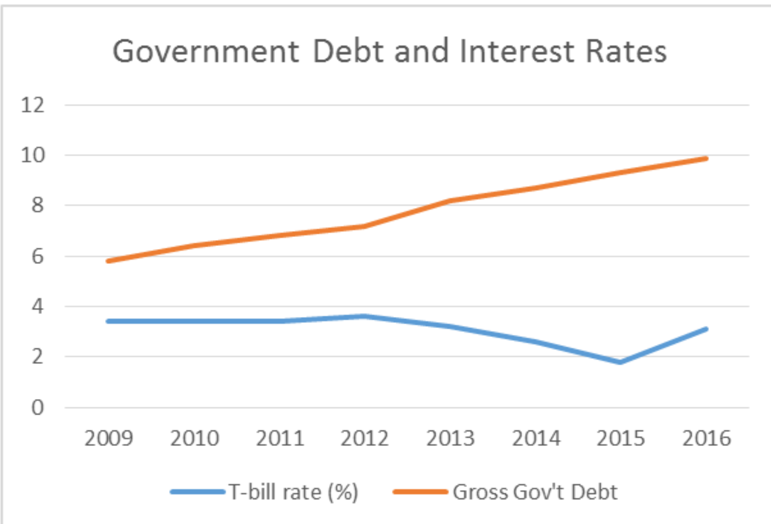
Last month I offered four examples of economic adjustment strategies which are worthy of emulation by Barbados, in our current circumstances. The countries chosen are all small economies that depend very heavily on imports, and they all boast standards of living higher than our own. Each one of them - Ireland, Iceland, Latvia and Cyprus - faced the need for cutbacks in public spending far in excess of what Barbados needs to do. They all took decisive action to reduce government consumption spending by substantial amounts; in the immediate aftermath of these measures their economic growth slowed, and in some cases there was a contraction in economic activity in the short term. However, the well-being of the population, as measured by the UNDP's Human Development Index, was unaffected throughout the crisis and adjustment, and today all four countries have improved their standing in the HDI. These four countries are worthy of emulation: they are of similar size to Barbados, their lifestyles are what we aspire to, they took the fiscal medicine, and now they are on a renewed growth path, with living standards in advance of what they enjoyed before their crises.

In contrast, our Caribbean neighbours offer no examples of clearly successful adjustment worthy of our emulation. Barbadians still enjoy a better quality of life, on average, than the rest of our region. Our country ranks at Number 54 in the 2016 *Human Development Report*, ahead of the Bahamas at Number 58, Trinidad and Tobago at Number 65, and Jamaica at Number 94. What is more, there are vitally important differences in the root causes of fiscal imbalances in the Caribbean, especially between Barbados and Jamaica.

The fiscal problem in Barbados is the very high cost of Government operations. The day-to-day running costs of Government - wages, use of services, supplies, and interest payments to pension funds, pensioners and investors - exceed tax revenues collected by Government, even though the Government collects as much as 30 cents of every dollar of income earned in the country. In the last fiscal year these running costs exceeded revenues by $341 million. The deficit on Government's current operations has now persisted every year for the past nine years. This is the root cause of Barbados' fiscal problem, and the reason the national debt keeps growing. Every year Government has had to borrow a substantial amount of money simply to keep the doors open every working day.

Jamaica's fiscal problem is quite different. The Jamaican Government has achieved a balance on the current account: in the 2015/16 Fiscal Year, revenues exceeded the cost of current operations by J$28 million, even though the Jamaican Government collects somewhat less in revenue than in Barbados, 27 cents in the dollar compared to Barbados' 30 cents. Jamaica's problem is that the interest costs of borrowing are very high. It was in an attempt to reduce those costs that Jamaica embarked on debt exchanges in 2010 and 2013. In both instances the lenders were offered new bonds to the full value of their old bonds in an exchange intended to reduce the interest rates, which were inordinately high; there was no haircut on the principal value invested. However, the policy has had limited success: after successive bond exchanges the interest rate on Jamaican Treasury Bills in 2016 was as high as 6.3 percent, double the corresponding rate for Barbados, which was 3.1 percent.

In contrast to Jamaica, the Government of Barbados pays a fair market rate on its debt. The Barbados Treasury Bill rate has remained largely unchanged since 2009, when interest payments amounted to 19 percent of revenue. Last Fiscal Year interest payments had risen to 26 percent of revenues, entirely because of the growth in the amount of debt outstanding. Government has borrowed more each year to fund running costs, but the bondholders have not been offered any additional return as an incentive to keep on lending.



The examples of small countries more prosperous than ourselves, as well as the analysis of our fiscal challenge, all point in the direction of cuts in Government's wages bill and reductions in transfers to state-owned entities as the way to eliminate the deficit on the current account. The tax burden is already considered high, which mitigates against the success of measures to increase tax receipts. The focus has to be on expenditure reduction. Interest payments cannot be touched; pensioners and pension funds depend on that income. Purchases of Government supplies have already been cut to the bone; the amount spent in the last fiscal year was $426 million, a decline of 26 percent since 2009, once you take account of inflation of 28 percent over that period. That leaves only wages and salaries and transfers to state-owned entities as targets for expenditure reduction.

In order to perform Government services with fewer staff, Government and state corporations will need to re-organise and implement effective use of new technology. This is an opportunity to increase levels of productivity and efficiency in the public service, thereby improving Barbados' score in the *Global Competitiveness Index*. In the *Global Competitiveness Report* "Inefficiency of Government bureaucracy" is identified as among the most serious business impediments. The experiences of Iceland, Ireland, Latvia and Cyprus, as well as Barbados' own experience in the early 1990s, offer reassurance that there will be no reduction in the national living standards and quality of life resulting from a significant cut in Government expenditure. More importantly, decisive reform of the public service releases the fetters on investment and enterprise in tourism, other traded services, renewable energy, branded merchandise and cultural activites, opening the path to robust and sustained growth of the economy, and richer opportunities for all.